

Business Combinations under Common Control

Slide deck ③
Methods of accounting

Emerging Economies Group Meeting
Sao Paulo, Brazil, December 2017

Meeting agenda

Background

**Research and
outreach**

Next steps

Slide deck 1

**Scope of
the project**

Slide deck 2

**Methods of
accounting**

Slide deck 3



Disclaimer

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Project	Business Combinations under Common Control (BCUCC)		
Paper topic	Methods of accounting		
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Overview of Slide deck ③

Content

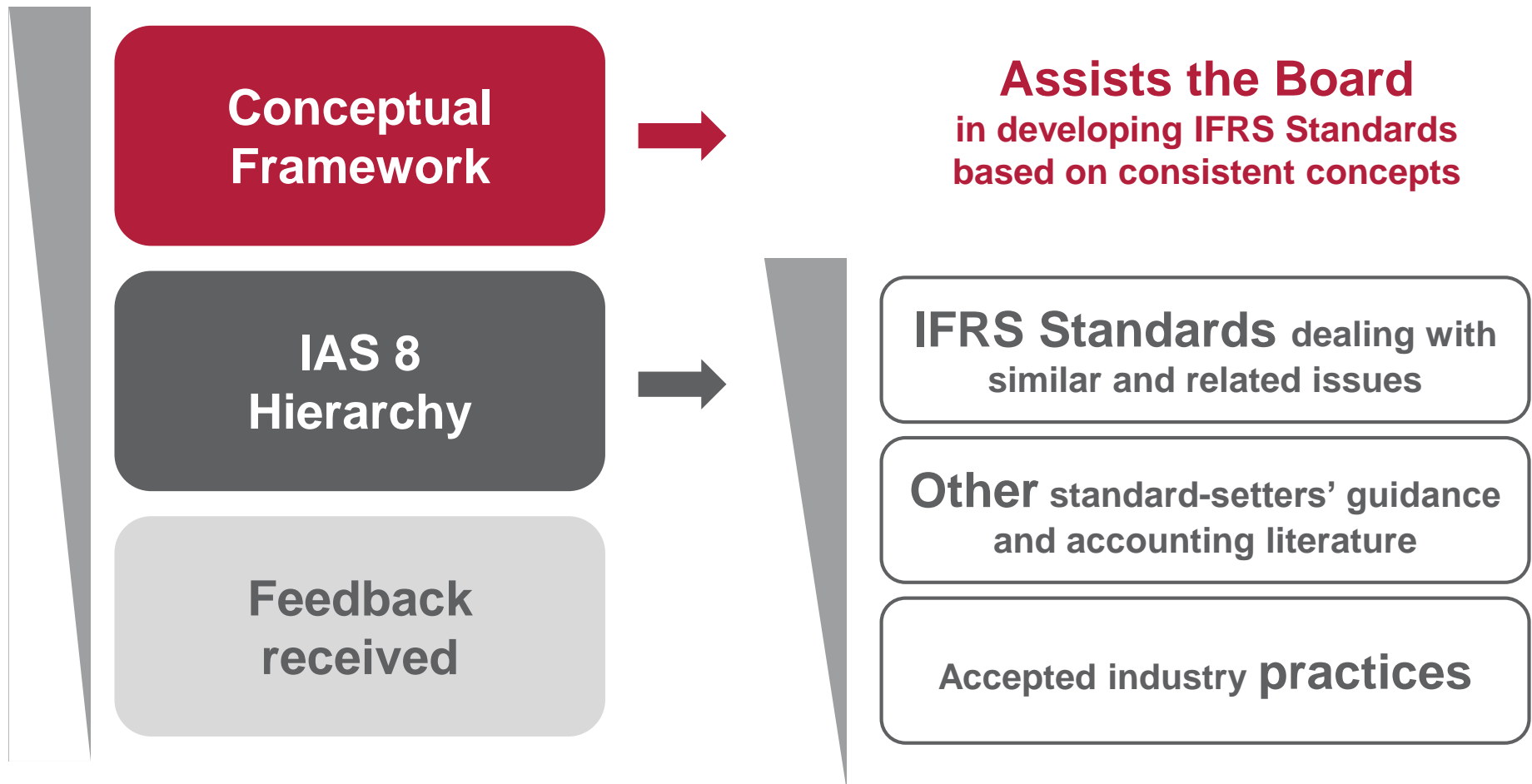
- **Identifying alternatives (slides 6-8)**
- **Selecting a starting point (slides 10-14)**
- **Selecting an accounting method for particular transactions**
 - **Identifying the factors to be considered (slide 17)**
 - **Process for assessing the factors (slides 18-22)**
 - **Discussion and analysis (slides 23-34)**

Objective

The objective of the session is to seek your views on the starting point and the factors to be considered in selecting an appropriate accounting method for transactions within the scope of the project.

Identifying alternatives

Sources of guidance



Identified alternatives

Acquisition method

Described in IFRS



Net assets of the acquired entity at fair values.

Comparative information for the acquirer only.

Predecessor method

Not described in IFRS



Net assets of all combining entities at carrying amounts.

Comparative information for the acquirer only or for all entities?

Fresh start method

Not described in IFRS



Net assets of all combining entities at fair values.

No comparative information?

Allocation of cost

Described in IFRS



Consideration transferred allocated to the acquired net assets.

Comparative information for the acquirer only.

*Use as
a starting point*

*Consider as
project progresses*

Further observations

Acquisition method

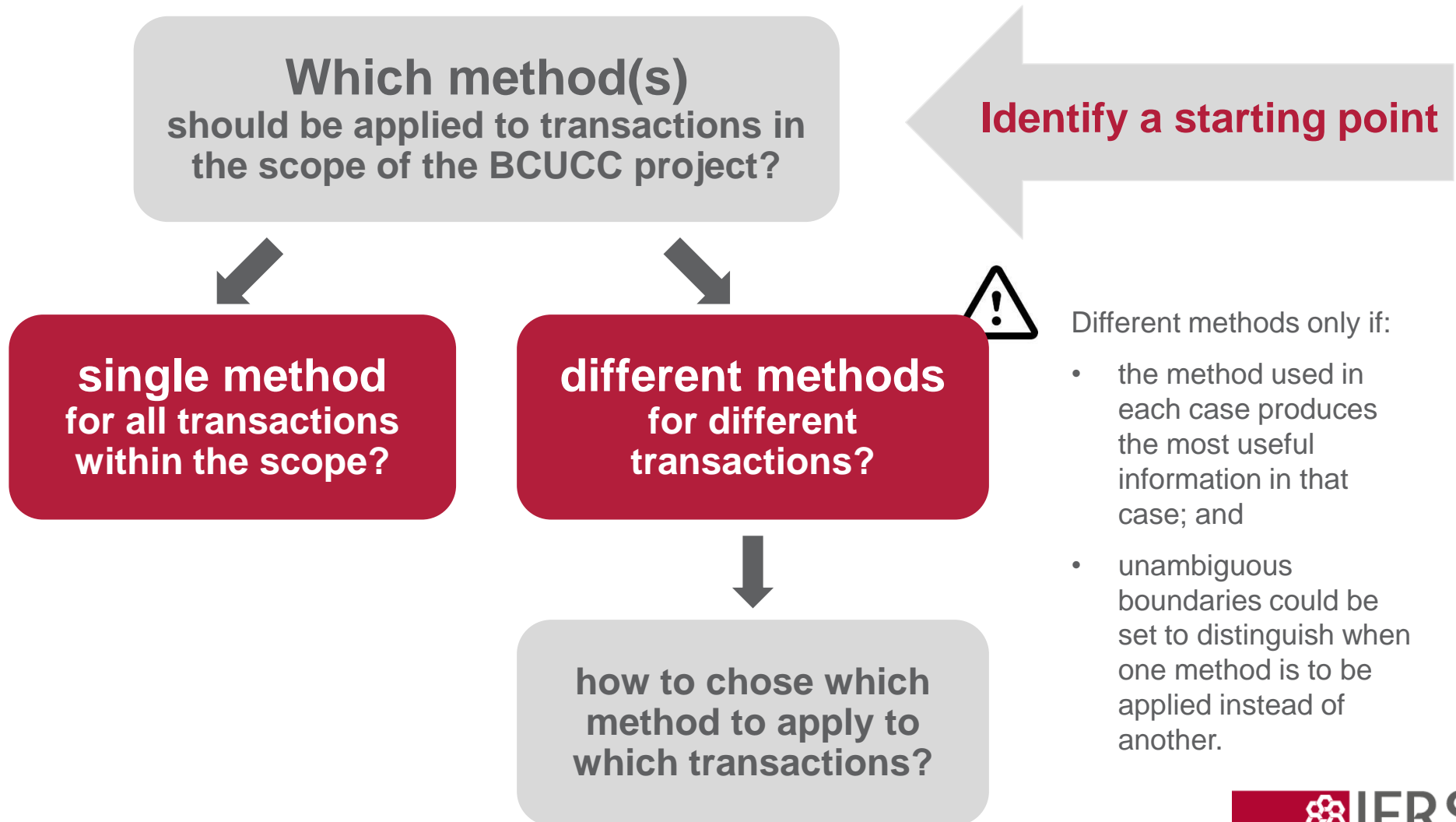
- ✓ Transaction **is viewed as an acquisition** from the perspective of the entity identified as **the acquirer**.
- ✓ **Asymmetric** in how it treats net assets and comparative information of the combining entities.

Predecessor method

- ✓ Transaction **can be viewed differently** depending on which perspective is taken:
 - ❖ **the acquirer;**
 - ❖ **the combining entities;** or
 - ❖ **the controlling party.**
- ✓ **Not necessarily asymmetric** in how it treats net assets and comparative information of the combining entities.

Selecting a starting point

Selecting an accounting method



Approach 1—start with acquisition method

Acquisition method as the starting point

Are the transactions in the scope of BCUCC project substantially **different** from business combinations **not** under common control?

Staff preliminary view



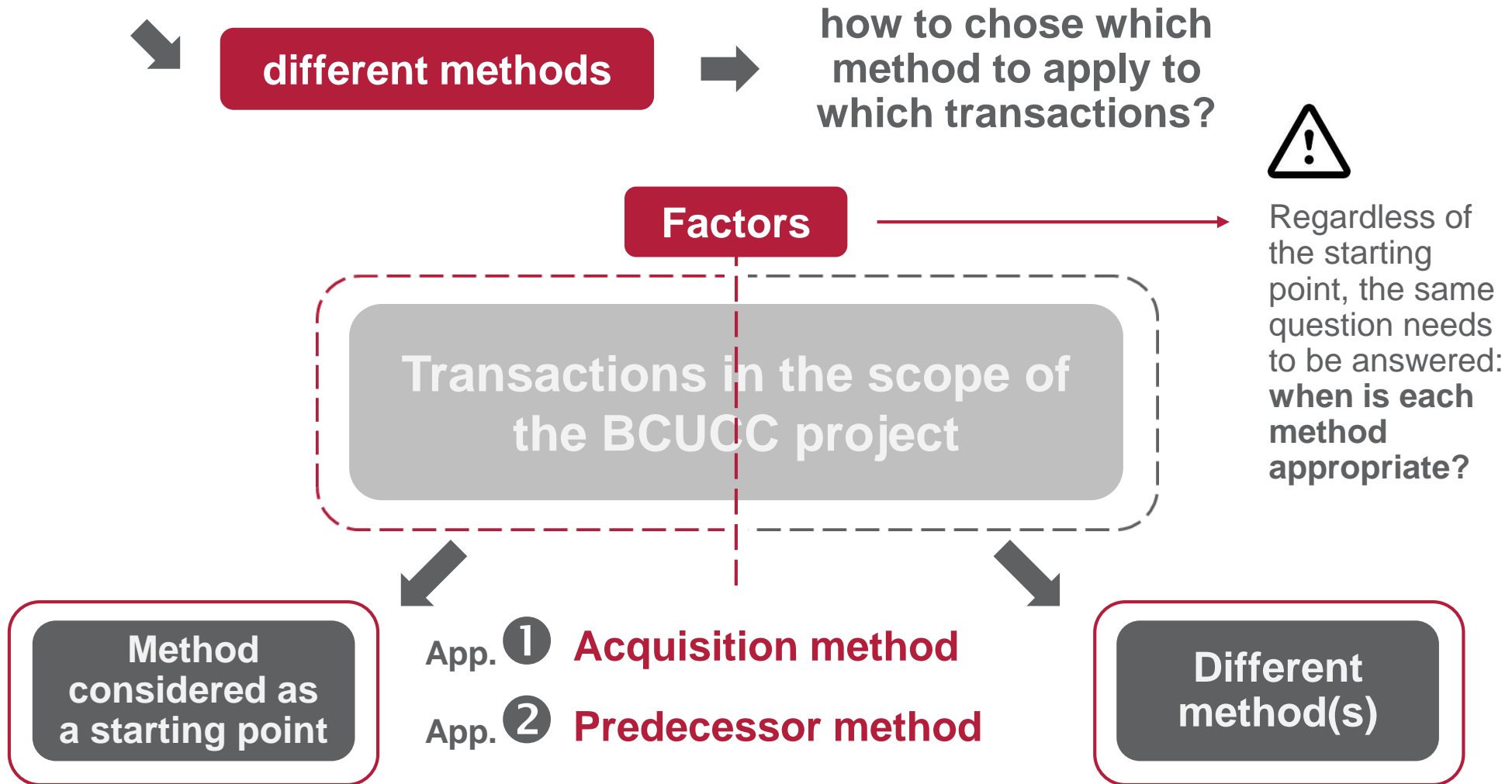
	NO	YES, ALL	YES, SOME
One or more methods?	ONE	more than ONE?	more than ONE!
Which method(s)?	ACQUISITION METHOD	METHOD(s) \neq ACQUISITION METHOD	METHOD(s) + ACQUISITION METHOD
Further questions?	none	which METHOD(s)?	which METHOD(s)? TRANSACTIONS?

Approach ②—start with predecessor method

Predecessor method as the starting point

- **IFRS 3 excludes BCUCC from its scope.** Accordingly, some argue that the acquisition method set out in IFRS 3 is not an appropriate starting point.
- **BCUCC are different** from business combination not under common control in that **there is no change in ultimate control** over the transferred business(es).
- Given the **continuity of control**, some argue that it would normally be appropriate to **retain carrying amounts** (predecessor method).
- However, using **fair values** for the transferred business(es) can provide more useful information **in particular circumstances** (eg when the change in the ownership interest in the transferred business is significant).

Approach ① and ②—implications



Discussion



- What are your **views on the approaches** illustrated in the previous slides (Approach ①—acquisition method as a starting point *versus* Approach ②—predecessor method as a starting point)?

Selecting an accounting method for particular transactions

Overview

Step 1

Identify factors to be considered in selecting an accounting method for particular transactions

Slide 17

Step 2

Decide on a process for assessing the impact of each factor on selecting an accounting method

Slides 18-22

Step 3

Bringing it all together: consider each factor identified in Step 1 applying the assessment process described in Step 2

Slides 23-34

Step 1—identify factors to be considered

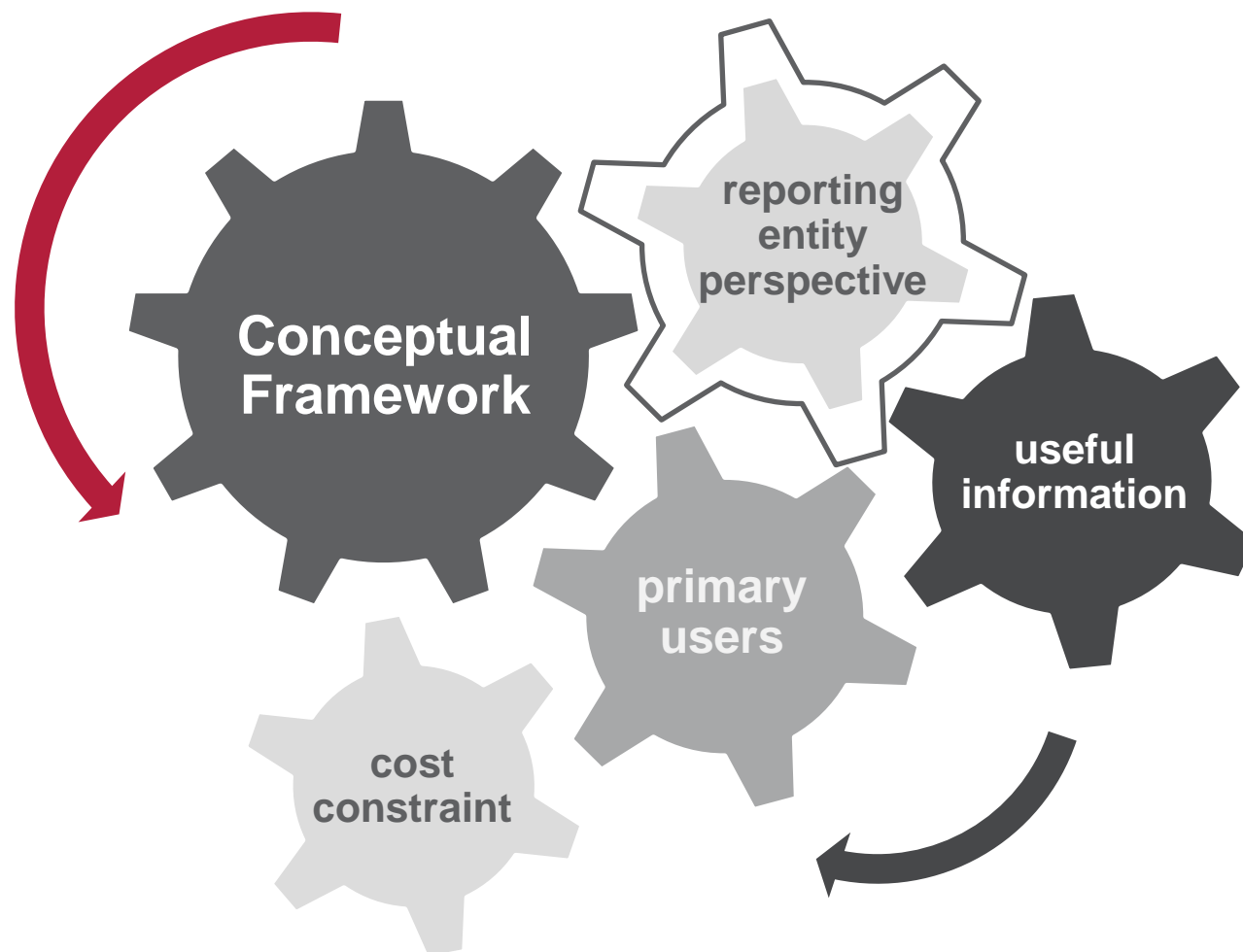
Other standard-setters' requirements

Publish guidance on BCUCC

Feedback from outreach and discussion

- **Decision making process**
- **Purpose of the transaction**
- **Consideration**
 - Pricing of the consideration
 - Form of the consideration
 - Evidence of fair value
- **Commercial substance**
- ...

Step 2—process for assessing the factors



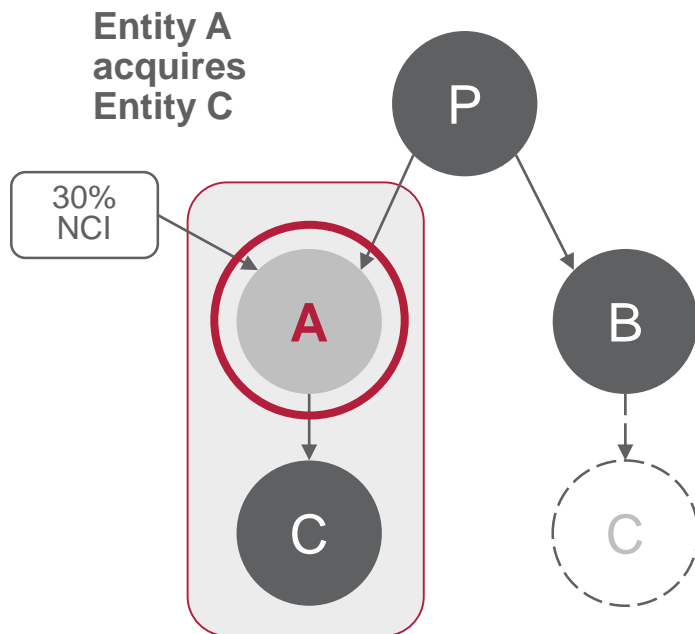
Refer to the guidance in the ***Conceptual Framework***.

Step 2 | Reporting entity



Financial statements provide information about transactions and other events **viewed from the perspective of the reporting entity.**

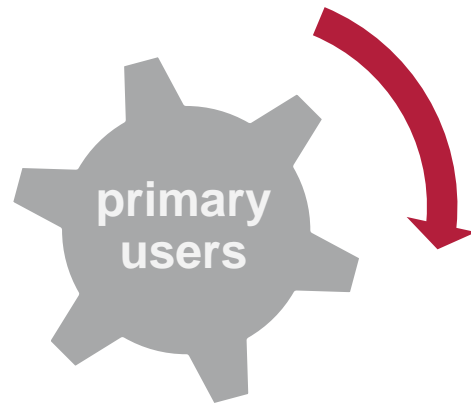
(Paragraph 3.9 of the *Conceptual Framework ED*)



In the **BCUCC** project, we focus:

- on the **perspective of the combining parties**;
- **NOT** on the controlling party's perspective;
- **NOT** on the transferring party's perspective.

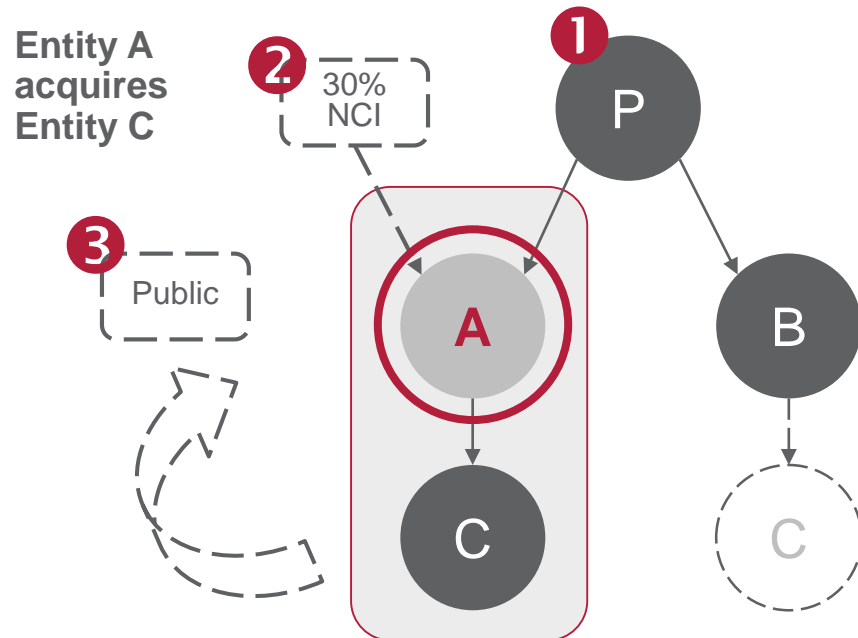
Step 2 | Primary users



Primary users of financial statements are potential and existing investors, lenders and other creditors.

(Paragraph OB5 of the *Conceptual Framework*)

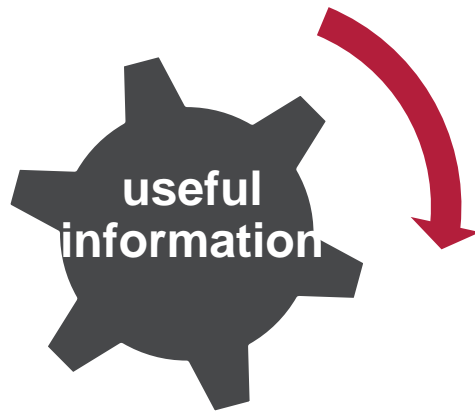
In a transaction within the scope of the BCUCC project, primary users include:



- 1 controlling party(ies);
- 2 non-controlling interest;
- 3 potential investors in a prospective IPO;
- 4 lenders and other creditors.

In the BCUCC project, we focus on external parties.

Step 2 | Useful information



The objective of general purpose financial reporting is to provide financial **information** about a reporting entity that is **useful** to the primary users of the entity's financial statements in making decisions relating to providing resources to the entity.

(Paragraph OB2 of the *Conceptual Framework*)

useful

relevant

faithfully
represent the
substance

comparable

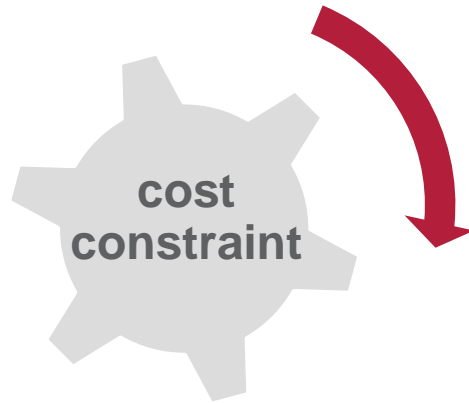
verifiable

timely

understandable

When selecting an accounting method, it is important to **consider the information that the method will produce in both the statement of financial position and the statement(s) of performance of the reporting entity** (see slide 7).

Step 2 | Cost constraint



Cost may constrain the selection of an accounting method: in selecting an accounting method it is important to consider **whether the benefits** of the information provided to users of financial statements will **outweigh the costs** of providing and using that information.

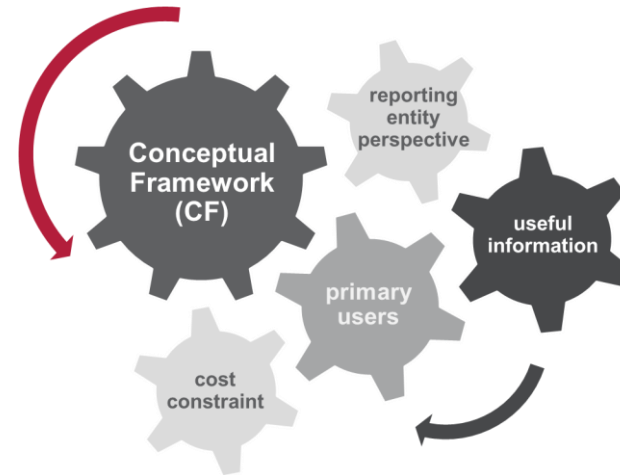
(Paragraph QC35 of *Conceptual Framework*)

	Acquisition method	Predecessor method
Cost constraint	Fair values may not be readily available and entities may be required to perform business valuation (often, no observable fair value inputs): more costly and time consuming.	Carrying amounts are readily available: easier and faster to apply and does not require keeping two sets of accounting records.

Step 3—discussion and analysis

Identified factors

- Decision making process
- Purpose of the transaction
- Consideration
- Commercial substance
- ...



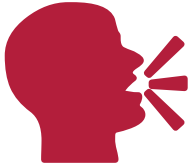
How to assess factors



In the BCUCC project we focus on external parties, rather than parties that have access to information without relying on the reporting entity's financial statements

Which method would provide the most **useful information** for the **primary users** of the **reporting entity's** financial statements, at a **cost** that can be justified by the benefits of that information?

Step 3—discussion and analysis



- For **each factor** identified by the staff, we would like to discuss **whether and how**, in your view, the factor **influences the decision about which method should be applied** to particular transaction, and why.

Step 3 | Decision making process (1/2)

Decision making process

What do we mean?

- Some transactions may be initiated and negotiated by the combining entities which may also involve a formal tender process.
- Other transactions may be initiated and directed by the controlling party without any party to the combination being involved in the decision-making process.
- In some cases, even if the transaction is initiated by the combining parties, the controlling party approves the combination and/or determines the terms of the transaction.

Step 3 | Decision making process (2/2)

Has the transaction been negotiated by the combining entities or directed by the controlling party?

Combining entities

Controlling party

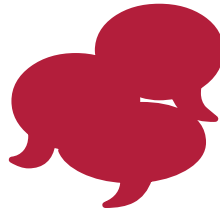
Which method would provide most useful information for the **primary users** of the reporting entity's financial statements, at a cost that can be justified by the benefits of that information?

NCI

Investors in IPO

Lenders & creditors

Controlling party



... discussion ...



... discussion ...

Step 3 | Purpose of the transaction (1/2)

Purpose

What do we mean?

A transaction might be conducted for the **benefit of**:

- **the combining entities** (eg a vertical integration—a transaction brings the reporting entity additional distribution channels for its products);
- **the controlling party and/or other entities controlled by that controlling party** (eg a transaction conducted for tax efficiency purposes for the group).

The combining entities' **existing activities** and **how these activities are managed** may help assessing the purpose of the transaction (eg activities that can efficiently be integrated).

Step 3 | Purpose of the transaction (2/2)

Does the transaction mainly benefit the combining entities or the controlling party?

Combining entities

Controlling party

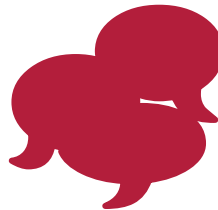
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NCI

Investors in IPO

Lenders & creditors

Controlling party



... discussion ...



... discussion ...

Step 3 | Consideration (1/4)

Consideration

What do we mean?

- **Pricing of the consideration**—the consideration transferred in the transaction is determined using the same assumptions that market participants would use when pricing the transferred business(es) if those market participants act in their economic best interest.
- **Form of the consideration** (shares, cash, assets, debt ...).
- **Evidence of fair value**—the fair value of the consideration is supported by independent evidence such as:
 - independent appraisals/valuations by appropriately qualified parties that are not related to the combining entities;
 - comparable recently quoted market prices, in an open and unrestricted market;
 - comparable independent bids on the same transaction; or
 - comparable amounts of similar transactions actually undertaken with unrelated parties.

Step 3 | Consideration (2/4)

Is the consideration determined using the same assumptions that market participants would use?

YES

NO

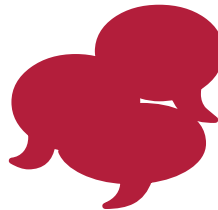
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NCI

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Lenders & creditors

Controlling party



... discussion ...



... discussion ...

Step 3 | Consideration (3/4)

Has the consideration been transferred in a form other than shares?

YES

NO

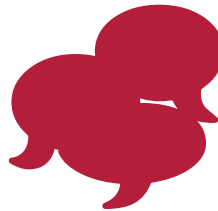
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Lenders & creditors

Controlling party



... discussion ...



... discussion ...

Step 3 | Consideration (4/4)

Can the fair value of the consideration be supported by independent evidence?

YES

NO

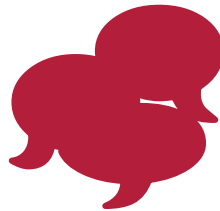
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NCI

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Lenders & creditors

Controlling party



... discussion ...



... discussion ...

Step 3 | Commercial substance (1/2)

Commercial substance

What do we mean?

- Significant changes in the reporting entity cash flows as a result of the transaction. This concept is already described in IFRS Standards (IAS 16.24 and IAS 38.46).
- The assessment focusses on the combining entities' cash flows, not on the overall cash flows of all entities controlled by the controlling party.

Step 3 | Commercial substance (2/2)

Does the transaction have commercial substance for the combining entities?

YES

NO

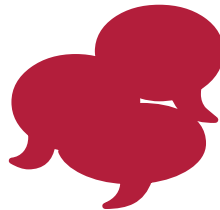
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NCI

Investors in IPO

Lenders & creditors

Controlling party



... discussion ...



... discussion ...

Discussion



- In your view, are there any additional factors that should be considered?
- Do you have any other observations you would like to share with us?



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